ZINNECKER BIMONTHLY – DECEMBER 2021 / JANUARY 2022

REVIEW

The interest rate and monetary policies of the U.S. Federal Reserve and the ECB have deliberately kept government bond yields low to date, despite enormous increases in inflation rates. This has helped member countries continue to borrow cheaply, at the expense of savers and investors. They have taken flight and, despite record highs on the stock markets, increasingly shifted assets into risk capital. Since the last report, despite the correction that has taken place, the USA has once again outperformed Europe with a gain of 6% measured by the S&P500 and 9% measured by the NASD100. German equities were off with -2% measured by the DAX price index and Japan even with -5%. Over the year, only the U.S. and Europe hit new all-time highs in November. German and Japanese stock indices did not advance beyond their annual highs of August and February, respectively. Over the comparable period, the dollar gained about 2% against the euro and is back to its December 2019 level after its weakness in 2020. Gold ounce, on the other hand, gained only 2% despite increased inflation expectations. It is still 13% below its August 2020 record high. These comparisons of figures show how differently the individual categories and stock markets have performed, not to mention the groups of stocks and the individual stocks in the respective indices. It has therefore not been an easy year for active and internationally investing asset managers to always be on the sunny side of the markets.

OUTLOOK

If one analyzes and evaluates the various factors influencing the global economies and, derived from this, the development of the respective capital markets for 2022, this picture should not change in the next twelve months. Corona in its third year, disrupted supply chains, demonetization, industrial climate change and employment form the cornerstones of future policies of old and new governments. The unchecked pandemic is undoubtedly the greatest risk factor in the coming years for structural economic recovery in Europe and the other industrialized countries. According to regional experience and a wide variety of successes in all countries, normality will not be achieved in the industrialized world without complete herd immunity. Germany will therefore soon have to introduce general mandatory vaccination if the epidemic is to be history after three years at the end of 2022. This also applies to the EU. This is the first hurdle that the new German government will have to overcome if its "Dare to make more progress" program is to be supported by society.

The second hurdle is global supply chains, whose production and transport slumps have made the prices of energy, fossil fuels, metals, intermediate products, staple foods and animal products more expensive than they have been for decades. This development has already been reflected in the prices of many everyday products and all short- and long-lived consumer goods and services. For the first time in years, companies have managed to pass on their increased costs to the end consumer.

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This has set in motion an global inflationary spiral which already exceeded 5% in November also, in Germany too, and has not yet reached its zenith.

Even if this enormous inflation spurt has been generated by technical problems, it is to be expected that demonetization will once again become an issue for policymakers and central banks in the coming years and that the specters of deflation will have been banished. The return to normalcy and the level of future inflation rates will depend primarily on the speed with which supply chains are restored. Progress is already becoming visible, and they should start functioning again in the course of the year. The second influencing factor is undoubtedly the wage and salary changes of coming years. The level of these and their ability to be enforced will depend on the changes in labor market structures over the past decade. Industrialized countries whose labor markets have been exhausted by fundamental changes in the economy and industry, by labor market movements and by the age development of the population pyramids will make much higher wage concessions in the future than has been the case in the past. This applies equally to skilled workers as well as to all skilled trades and service occupations, occupations in the IT sector, engineering and all occupations in research and development. In many countries, socio-political and distributional aspects also play a major role in future wage and salary determination. This is particularly true of Germany, which has neglected distributive justice over the past 30 years.

At present, after the inflationary push triggered by Corona and the disrupted supply chains has subsided, the majority of economists expect an inflation rate of between 2-3% for 2022 and 2023, depending on the region. This means that the central banks' target of 2%, which has been set for years, has finally been met. Despite the sharp increase, the U.S. Federal Reserve and the ECB do not yet see any need to change existing policy, as they view the rise as essentially technical in nature. This assessment would only change if bottlenecks in the labor markets were to set in motion a wage and salary spiral, which would then violate the objectives of monetary stability. It can no longer be ruled out that this could occur as early as next year.

For the time being, interest rates are locked in the existing corridors, which make it much easier for the industrialized countries to finance the necessary transformation and realignment of their economies toward climate neutrality. Added to this, are the costs of dealing with the pandemic. The other European countries also face similar challenges. In addition to these mammoth tasks, Germany also bears the burden of making up for and financing the backlogs in the modernization and expansion of its infrastructure that have arisen over the past 10 years. This cannot be achieved without significant new borrowing, which is why it is important that government financing costs remain low for as long as possible.

CAPITAL MARKET OUTLOOK

The new mutant "Omikron" was merely the trigger for the expected technical correction on the stock markets, which - as in the past - was stronger in Germany, the EU and Japan than in the USA. While it fits into the overall picture, it is only one piece in the puzzle for the development of the capital markets for 2022. However, inflation and interest rate developments, economic trends in the industrialized countries and corporate earnings growth will be the

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valuation parameters for the direction and returns of the individual asset classes: cash, bonds and equities. Despite the ongoing pandemic in the fourth wave with new adjustment problems, the economies will recover in the course of the year after the spring. The supply/demand tensions in the supply of goods triggered by the disrupted supply chains should dissipate to the extent that the pandemic is substantially or even completely contained by health authorities in all countries during the year.

The level of recovery of the global economy, which is already experiencing a visible dent and could extend into the first quarter of 2022, depends crucially on this. If one follows the economists at Morgan Stanley, their GNP estimates for 2022 of 4.7% globally after 6.1%, 4.6% for the USA after 5.5% and 4.6% for the euro zone after 5.2% seem to me to be too ambitious. This also applies to Germany, which will also bring up the rear next year after growth of just 2.7% in 2021.

The easing of inflation would take the pressure off central banks to step on the brakes too much. However, the capital markets should assume that capital market interest rates will continue to rise slightly over the rest of the year without causing distortions on the overheated real estate markets - especially in the USA. US 10-year yields could settle in the range of 1.8% to 2%, which should also result in slight interest rate increases in Europe.

Money and capital investments in bonds will therefore continue to suffer from negative real interest rates. Although the equity bull markets have been on an upward trend since March last year, equities are still undervalued relative to bond yields in a long-term comparison. U.S. corporate earnings should grow by about 8-10% p.a. over the next 2 years. At an index level of approx. 4600 for the S&P500, equities would then be attractively valued at 20 and 19 times for 2022 and 2023 respectively. The corporate profits of European companies should also improve on average by approx. 7-9% per year, so that in my opinion equity investments in this part of the world are also generally recommendable in the longer term. The investment needs of private investors are far from exhausted. This is particularly true for Generation Y, the millennial generation, of today's 25-40 year-olds, who need to save for an additional pension via funded pensions in order to secure their standard of living in old age.

However, against the uncertain interest rate backdrop, the scope for further upside potential in the stock markets should be limited. The degree of upward movement should level off in the course of the year, so that large index gains over the year are no longer likely. In the second half of this bull market, which may last into 2023, group and stock selection should therefore determine investment success even more than they did this year. As in every previous equity cycle, the winners from now on should be global companies whose products have unique selling propositions, are scalable and not cyclical, i.e., companies that are able to increase sales of their branded products and services disproportionately as the economy progresses. This applies equally to consumer goods, durables and capital goods. Stocks with these characteristics can be found, for example, in many areas of electronics, information technology (FAANG), high-value and non-cyclical consumer goods and services, pharmaceuticals, and the healthcare industry.
30.11.2021

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